

LAW OFFICES

STRANG, FLETCHER, CARRIGER, WALKER, HODGE, & SMITH, PLLC

CARLOS C. SMITH
WILLIAM C. CARRIGER
RICHARD T. HUDSON
EWING STRANG
LARRY L. CASH *
CHRISTINE MABE SCOTT *
J. ROBIN ROGERS # *
G. MICHAEL LUHOWIAK
GREGORY D. WILLETT
MARK W. SMITH *
STEPHEN D. BARHAM

OF COUNSEL
ROBERT KIRK WALKER
FREDERICK L. HITCHCOCK

400 KRYSTAL BUILDING
ONE UNION SQUARE
CHATTANOOGA, TENNESSEE 37402-2514

TELEPHONE 423-265-2000
FACSIMILE 423-756-5861

January 2, 2003

S. BARTOW STRANG
1882-1954

JOHN S. FLETCHER
1879-1961

JOHN S. CARRIGER
1902-1989

JOHN S. FLETCHER, JR.
1911-1974

ALBERT L. HODGE
1910-1997

F. THORNTON STRANG
1920-1999

* ALSO LICENSED IN GEORGIA
* ALSO LICENSED IN ALABAMA

Ms. Patsy Fulton
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

Re: Electric Power Board Telecommunications

Dear Patsy:

Enclosed is the Internal Audit Report for fiscal year 2002.

Please contact us if you have any questions.

Sincerely yours,



William C. Carriger
For the Firm

WCC:tm
EPB/TEL - #157
Enclosures

RECEIVED
03 JAN 9 AM 10 11
TN REGULATORY AUTHORITY
DOCKET ROOM

97-07488

RECEIVED
JAN 03 2001
TN REGULATORY AUTHORITY
TELECOMMUNICATIONS DIVISION

■ Memo



To: Harold DePriest

CC: Bill. Chapman
Preston Suggs

From: Internal Audit *JA*

Date: December 31, 2002

Subject: Audit of EPB Compliance with TRA Telecommunications Requirements

Executive Summary

Purpose

An audit of EPB Compliance with TRA (Tennessee Regulatory Authority) Telecommunications requirements for fiscal year 2002 has been completed. The objective of the audit was to determine if EPB is in compliance with the conditions set forth in TRA Docket No. 97-07488 and any supplemental conditions or provisions ordered by the TRA. The code of conduct was not reviewed in this audit, but was reviewed in a separate audit.

Scope

The results of the audit are based on a review of TRA Docket No. 97-07488, a review of procedures, audit tests deemed necessary under the circumstances, and inquiries and observations made by Internal Audit.

Opinion

In our opinion, EPB is in compliance with the conditions set forth in TRA Docket No. 97-07488 and any supplemental conditions or provisions ordered by the TRA, except for minor exceptions and improvements. Minor exceptions should be corrected and improvements made in certain areas.

DETAILS OF OBSERVATIONS AND RECOMMENDATIONS

Introduction – How to Read This Report

Each of the audit observations listed in this section of the report contains five specific elements or parts.

1. Criterion – The standard used by the Auditor in evaluating the matter being audited. It may be a Board policy, a law, a regulation, a contractual obligation, or a generally accepted accounting or business practice.
2. Condition – What the Auditor found to exist in the course of the audit.
3. Cause – The reason for a deviation from the standard.
4. Effect – The result or risk caused by a condition deviating from the standard.
5. Recommendation – The Auditor's statement of actions that could be taken to correct the deficiency noted.

INDEX TO OBSERVATIONS

1. EPB is in compliance with TRA Docket No. 97-07488, except for minor exceptions and improvements.
2. Minor exceptions require correction, and improvements should be made in certain areas.

Distribution for response:

Observation 2 sent to:

Gary Hurst for a response
Copy to: Bill Chapman, Preston Suggs

1. Observation:

EPB is in compliance with TRA Docket No. 97-07488, except for minor exceptions and improvements

Criteria:

The TRA Docket No. 97-07488 sets forth requirements for EPB to properly separate telecommunications from electric power accounting data, provide assurance that subsidization does not occur, and to properly allocate cost.

Condition:

EPB is in compliance with major provisions of TRA Docket No. 97-07488. Some examples of compliance with major provisions include:

- a. Telecommunications accounting transactions are distinguishable from electric accounting transactions.
- b. Cost assignment and allocation are based upon the proscribed principles of: directly assignable costs; directly attributable costs; indirectly attributable costs; unattributable costs; intercompany loans; and taxes.
- c. Services provided to an affiliate pursuant to a tariff filed with a regulatory authority are recorded in the appropriate revenue accounts at the tariffed rate.
- d. Telecommunications maintains a bank account separate from those of the electric system for deposit of revenues.
- e. Leases between the Electric System and the Telecommunications System are at the highest rate paid by other outside parties.
- f. Telecommunications service revenues are recorded directly to telecommunications revenue accounts as they are earned.
- g. Telecommunications issues Reporting Requirements to the TRA on an annual basis.

Cause:

Management has made efforts to diligently comply with TRA requirements.

Effect:

Overall, EPB is in compliance with TRA Docket No. 97-07488, except for minor exceptions and improvements.

Recommendation:

N/A

2. Observation:

Minor exceptions require correction, and improvements should be made in certain areas.

Criteria:

The TRA Docket No. 97-07488 sets forth requirements for EPB to properly separate telecommunications from electric power accounting data, provide assurance that subsidization does not occur, and to properly allocate cost.

Condition:

Minor exceptions were noted in the allocations:

- a. In calculating the General Allocator, telecommunications cost of goods were not excluded, resulting in over-allocation of cost.
- b. Some administrative costs were not allocated to telecommunications.
- c. Auto insurance is allocated to telecommunications, but is also charged to telecommunications through daily vehicle charges.
- d. Leasehold improvements are charged to telecommunications, but may also be built into the building rental being charged telecommunications. This could not be determined since there is not a written building lease agreement.

Improvements should be made in the following areas:

- e. There has been very limited telecommunications marketing and advertising. Although inquiries and observations indicate compliance regarding marketing and advertising, the portfolio of such materials could be better organized to facilitate review.

Cause:

Minor oversights were made in interpretations, information gathering, and calculations. Also, the changing environment and growth of Telecommunications requires process improvements be made periodically.

Effect:

Expenses could be more precisely allocated.

Recommendation:

The minor exceptions noted above should be reviewed and corrected. Consideration should be given to better organizing the marketing and advertising portfolio of materials.